86-887 (1)

Supreme Court, U.S.
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No. _____

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In The
Supreme Court of the United States

October Term, 1986

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LARRY W. PASSAGE, et al.,
Petitioners,

v.

PRUDENTIAL-BACHE SECURITIES, INC.,et al.,
Respondents.

o

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF MONTANA

o

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QUESTION PRESENTED

Whether the Federal Arbitration Act can be constitutionally applied so as to require enforcement of an adhesive arbitration clause which fails to disclose to the adhering party that he is waiving his right to trial by jury, appellate review and judicial resolution of disputes?

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The Petitioners, Larry W. Passage, Twila Passage, and Neva Passage, individually and as custodian for minors Todd Passage and Allison Passage, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the Supreme Court of the State of Montana entered in this proceeding on August 26, 1986. The Respondents are G.T. Murray, William Crowley, Richard Dobbins, G.T. Murray Company and Prudential-Bache Securities, Inc.

OPINION BELOW

The opinion of the Supreme Court of the State of Montana as reported in ___P.2d___, 43 St.Rptr. 1532 (1986), appears in the Appendix hereto.

JURISDICTION

The judgment of the Supreme Court of the State of Montana was entered on August 26, 1986, and this petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. Sec. 1257(3).

QUESTION PRESENTED

Whether the Federal Arbitration Act can be constitutionally applied so as to require enforcement of an adhesive arbitration clause which fails to disclose to the adhering party that he is waiving his right to trial by jury, appellate review and judicial resolution of disputes?

STATUTORY PROVISIONS INVOLVED

United States Code, Title 9:

Sec. 2 Validity, irrevocability, and enforcement of agreements to arbitrate.

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, of an agreement in writing to submit to arbitration an

existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

17 C.F.R. Sec. 240.15C2-2 (in pertinent part)

(a) It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the federal securities laws, or to have in effect such an agreement pursuant to which it effects transactions with or for a customer.

(b) Notwithstanding paragraph (a) of this section, until Dec. 31, 1984 a broker or dealer may use existing supplies of customer agreement forms, if all such agreements entered into with public customers after Dec. 28, 1983 are accompanied by the separate written disclosure:

Although you have signed a customer agreement form with FIRM NAME that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

STATEMENT UNDER RULE 33(2)(b)

Since the proceeding draws into question the constitutionality of 9 U.S.C. Sec. 1, et seq.(Federal Arbitration Act) an Act of Congress affecting the public interest, and neither the United States nor any agency, officer, or employee thereof is a party, it is noted that 28 U.S.C. Sec. 2403(a) may be applicable.

STATEMENT OF THE CASE

In 1983, the Passages opened seven separate accounts with G.T. Murray Company in Helena, Montana - the local correspondent for Purdential-Bache Securities. Excluding the 2 custodial accounts, they were required to execute standardized Bache Client Agreements which contained arbitration clauses.

In February, 1985, the Passages filed suit in state district court in Montana charging G.T. Murray Company, William Crowley, Richard Dobbins, and G.T. Murray [hereinafter the "Murray" Respondents] and Prudential-Bache with various violations of state securities laws and duties with regard to a loss of some $335,000 (approximately 70%) in their accounts.

After suit was filed and depositions had been scheduled by the Passages, Prudental-Bache and Murray filed a demand for arbitation and sought from the district court a stay of all further proceedings. Prudential-Bache invoked the following clause in its standard Client Agreement:

> "Any controversy arising out of or relating to my account,to transactions with or for me or to this Agreement or the breach there-of, . . . shall be settled by arbitation in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchage as I may elect."

PRESERVATION OF THE QUESTION RAISED FOR REVIEW

The Passages opposed the motion to compel arbitration arguing that the clause was a contract of adhesion and was subject to equitable revocation under 9 U.S.C. Sec. 2. (Tr. p. 46-55) Despite Prudential-Bache's concession that the clauses were contracts of adhesion, (Tr.p.31-32,p.48) the state district court ruled that the arbitration clauses were valid as between the adult Passages and Prudential-Bache. While noting that the Passages, in signing the arbitration agreements, had "unknowingly" (Tr.p.60, l.3) given up enormous discovery rights, the district court stayed all further proceedings pending arbitration.

Prudential-Bache appealed from the court's conclusion that the children's accounts were not encompassed by an arbitration clause. The Passages cross- appealed contending that the arbitration clauses were not constitutionally enforceable as to any of the claimants; that the Federal Arbitration Act was unconstitutional as applied to the clauses in question since the Passages were not put on notice that they were waiving their right to a judicial forum. (Passages' Appeal

brief, pp. 7-12, and Reply brief, pp.4-5, filed with the Montana Supreme Court)

The Supreme Court of Montana found the arbitration clauses enforceable, noting that such clause are "universal" and that there was no evidence the clauses were unconscionable.

REASONS FOR GRANTING THE WRIT

1. THE DECISION BELOW RAISES SIGNIFICANT AND RECURRING PROBLEMS CONCERNING THE ENFORCEMENT OF ARBITRATION CLAUSES IN CONTRACTS OF ADHESION.

The decision below reflects important constitutional, statutory and policy considerations growing out of bona fide efforts to invoke the exception language of 9 U.S.C. Sec. 2, which mandates enforcement of arbitration clauses, "save upon such grounds as exist at law or in equity for the revocation of any contract." This Court has not had occasion to address the issue of the validity of an arbitration clause in a contract of adhesion. In *Dean Witter Reynolds v. Byrd*, 105 S.Ct. 1238, 470 U.S. 213 (1985), the Court, in footnote #2, noted that the respondent had argued that the contract in question was a contract of adhesion and thus subject to close judicial scrutiny and should not be routinely enforced. Since the respondent had not presented these arguments in the court below, this Court declined to address that issue on appeal.

Given this Court's recent opinion concerning the preemptive federal policy in favor of arbitration, *Southland v. Keating*, 465 U.S. 1 (1984), the lower courts have been reluctant to interpret the Federal Arbitration Act as creating anything but a presumption in favor of enforcing all arbitration clauses, both negotiated and adhesive.

The Courts are in agreement that there are two judicially imposed limitations on the enforcement of contracts of adhesion. The first is that an adhesive provision which does not fall within the "reasonable expectations" of the adhering or weaker party will not be enforced against him. The second is that a contract provision, even if consistent with the reasonable expectations of the party, will be denied enforcement if, considered in its context, it is unduly

oppressive or unconscionable. *Perdue v. Crocker Bank*, 702 P2d. 503, 511 (en banc) (Cal. 1985), *Finkle and Ross v. A. G. Becker Paribas, Inc.*, 622 F.Supp. 1505, 1511-12. (D.C.N.Y. 1985).

Despite the Securities and Exchange Commission's position that pre-dispute arbitration clauses in client agreements are deceptive and overreaching, 17 C.F.R. 240.15C2-2, *Woodyard v. Merrill Lynch*, 640 F.Supp. 760, 765 (S.D.Tex. 1985), the judicial trend has been to routinely enforce adhesive arbitration clauses since they are "universal" (App.7) or "prevalent" in the industry. *Finkle & Ross v. A.G. Becker Paribas, Inc.*, 622 F.Supp. 1505, 1512 (D.C.N.Y. 1985). Such leaps of logic incorrectly assume that the client is not only familiar with the "industry" practice but also that he is aware of the effect and meaning of the word "arbitration". Few courts have taken the step of analysing the specfic clause in question to determine what if any disclosures it provides or whether lack of disclosure results in an involuntary waiver of constitutionally protected rights to Due Process and judicial resolution of disputes.

This petition draws into question the industry wide practice of requiring securities client to execute arbitration clauses which require arbitration of "all" disuputes (including tort claims) and which fail to advise the adhering client of the rights which are thereby waived.

2. APPROPRIATE DISCLOSURE STATEMENTS WOULD RECOGNIZE THE TENSION BETWEEN THE POLICY GOALS OF THE ARBITRATION ACT AND THOSE OF INVESTOR PROTECTION

In signing an arbitration agreement, a securities client unknowingly waives numerous rights (trial by jury, appellate review, pretrial discovery, punitive damages), some of which are constitutionally protected. More than any other factor, the arbitration clause with its disclosures, if any, serves to frame the "reasonable expectations" of the adhering party. A blanket agreement to arbitrate all disputes does nothing towards advising the client as to the rights he is waiving.

The presumption that blanket agreements to arbitrate are valid, ignores this Court's teaching that courts should remain attuned to

claims that the agreement to arbitrate resulted from the sort of overwhelming economic power that would provide grounds for the revocation of any contract. *Mitsubishi Motors Corp. v. Solar Chrysler-Plymouth Inc.*, ____U.S.____, 105 S.Ct. 3346, 87 L.Ed.2d. 444, 455 (1985). Securities client agreements, which are "universal" and "prevalent" in the industry, are the result of such economic power.

Although arbitration clauses in security client agreements have been found not to be unconscionable or against public policy, the lower courts are in need of guidance as to what specific disclosures have to be included in such an agreement in order to lend meaning to the concept "reasonable expectation" and to the exception language of 9 U.S.C. Sec. 2. The lack of such disclosure may be of little significance in a negotiated contract. In a contract of adhesion, however, nondisclosure is nothing less than the overreaching and deceptive practice the S.E.C. has sought to prohibit in 17 C.F.R. 240.15C2-2.

The type of disclosures which Passages urge this Court to require do not run afoul of the strong federal policy favoring arbitration. Rather they require a recognition of the inherent tension between the policy goals of the Arbitration Act and those of investor protection.

Although there is no public policy which would militate against such disclosures, and although the S.E.C. has taken a strong stand against pre-dispute arbitration clauses, the lower courts routinely enforce boilerplate clauses which provide no disclosure whatsoever. *Rush v. Oppenheimer & Co., Inc.* 638 F. Supp. 872 (S.D.N.Y. 1986), *Surman v. Merrill Lynch*, 733 F.2d 59, 61 n.2 (8th Cir.1984) and *Brener v. A.G. Becker Paribas, Inc.*, 628 F.Supp. 442 (S.D.N.Y. 1985). *Contra, Obstetrics & Gynecology v. Pepper*, 693 P.2d. 1259 (Nev. 1985), In *Pierson v. Dean, Witter, Reynolds, Inc.* 742 F.2d 334, 339 (7th Cir. 1984), the Seventh Circuit, while noting that the Piersons *perhaps* did not contemplate loss of their right to trial by jury, found that such a loss is a "necessary and fairly obvious consequence of an agreement to arbitrate." The Circuit Court then faulted the Piersons for not inquiring about the "ramifications" of an agreement to arbitrate. Without discussing the doctrine of

"reasonable expectations", the Court found that the agreement was not unconscionable.

Having firmly established the national policy in favor of arbitration, the Court should address the question of what disclosures are necessary to insure that an investor "knowingly" enters into the agreement to arbitrate. It is one thing for the judiciary to embrace the policy favoring arbitration. It is quite another to impart to firms a freedom from legal restraint through use of contracts of adhesion. *See,* Contracts of Adhesion: An Essay in Reconstruction, Todd D. Rakoff, Vol. 96 Harv. L. Rev. 1173, 1229 (1983).

When an arbitration clause, such as that involved herein, does nothing more than state that the party agrees to arbitrate all disputes and controversies, there is a serious question as to whether the adhering party "reasonably expects" that he is waiving his right to a judicial resolution, with trial by jury and appellate review. Decisions, such as the decision below, which place the burden on *the investor* to show that the agreement exceeded his reasonable expectations, are open to serious question and may be constitutionally infirm. Due Process of Law, as garanteed by the Fifth and Fourteenth Amendments, requires that if pre-dispute, adhesive arbitration clauses are to be held conscionable, the burden must be on *the drafting party* to provide minimum disclosures as to the waivers inherent in the agreement.

There is no justification for engaging in the fiction that loss of the right to trial by jury is a "necessary and fairly obvious consequence of an agreement to arbitrate." *Pierson v. Dean, Witter, Reynolds,* 742 F.2d at 339. Rather than faulting the securities client for not inquiring about the ramifications of an agreement to arbitrate, the courts should be inquiring why the boilerplate client agreement does not advise the client that he is waiving his rights to judicial resolution of claims, both tort and contract.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Supreme Court of the State of Montana.

Respectfully submitted,

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Nov. 18, 1986

CERTIFICATE OF SERVICE

I hereby certify that on this 18 day of November, 1986, three copies of the Petition for Writ of Certiorari were mailed, postage prepaid, to:

Mr. Michael Mulroney, P.O. Box 1144, Helena, Montana, 59624, counsel for the Murray Respondents,

Mr. Dan Shea, at 800 Broadway, Helena, Montana, 59601, counsel for Prudential-Bache Securities.

The Solicitor General, Department of Justice, Washington, D.C. 20530.

I further certify that all parties required to be served have been served.

W. William Leaphart
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Helena, Montana 59601
Counsel for Petitioner

APPENDIX A

IN THE SUPREME COURT OF THE
STATE OF MONTANA

LARRY PASSAGE et al., Respondents, v.
PRUDENTIAL-BACHE et al., Appellants

No. 85-459

August 26, 1986

Appeal from the First Judicial District Court, Lewis & Clark County, Hon. Gordon Bennett, Judge.

For Appellant: Danial J. Shea argued for Prudential-Bache, Michael J. Mulroney argued for G. T. Murray.
For Respondent: W. William Leaphart argued for Passages.

Opinion by Justice Weber; Chief Justice Turnage and Justices Harrison, Gulbranson, Sheehy and Hunt concur. Justice Morrison dissents and filed an opinion.

Affirmed in part and reversed in part.
Mr. Justice Weber delivered the Opinion of the Court.

In this case, all parties appeal portions of an order of the District Court for Lewis & Clark County which held that claims on some of the Passages' accounts with defendants were subject to valid arbitration clauses. We affirm in part and reverse in part.

The issue are:
1. Did the District Court correctly determine that it had jurisdiction to order arbitration of the Passages' claims under the Federal Arbitration Act?
2. Are the arbitration agreements in this case adhesion contracts, and if so, are they unenforceable?
3. Did the District Court err in directing that arbitration be

conducted under the rules of the American Arbitration Association as elected by the Passages?

4. Which parties are entitled to benefit of the arbitration agreement?

5. Did the District Court properly stay the claims of the children pending arbitration of their parents' claims?

Prudential-Bache Securities, Inc. (Prudential) is the New York correspondent of G.T. Murray Company. The other three defendants are or were officers or employees of G.T. Murray Company. Beginning in 1983, the Passages opened several accounts at the G.T. Murray office in Helena, Montana. The accounts included two "target accounts" and two regular accounts, with total depostis of $429,403.30. Neva Passage also opened accounts for each of their two children with total deposits valued at $13,440.97. Larry Passage opened an account for Twila Passage, his mother, with total deposits valued at $27,187.51. When they opened their regular and target accounts, Larry and Neva Passage signed customer agreement forms, a copy of which is appended to this opinion. Twila Passage also signed a customer agreement form. The customer agreement forms included arbitration clauses providing as follows:

"Any controversy arising out of or relating to my account, to transactions with or for me or to this Agreement or the breach thereof, . . . shall be settled by arbitration in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchange as I may elect. If I do not make such election by registered mail addressed to you at your main office within five (5) days after demand by you that I make such election, then you may make such election."

In February 1985, the Passages filed suit in the District Court for Lewis & Clark County, charging defendants with various violations of state securities laws and dutes in handling their accounts. The complaint alleged losses in the regular and target accounts of $320,104.82, losses in the children's accounts of $4,770 and loss in the Twila Passage account of $10,210.15. Defendants filed demands for arbitration. The District Court found that the accounts, except for the children's accounts, were subject to valid arbitration clauses and granted the motion of defendant Prudential-Bache to compel

arbitration. It denied the motion of defendants G.T. Murray (the Murray defendants) to compel arbitration. It held that there was a question of whether the Murray defendants had standing to demand arbitration, but stated that this was immaterial since Prudential undisputedly had the necessary standing. The court also held that the client agreements containing the arbitration clauses did not apply to the accounts opened in the names of the Passage children, but it stayed judicial proceedings on the children's claims until arbitration is completed on the other claims. Each of the parties has appealed on portions of the judgment which are unfavorable to it.

I.

Did the District Court correctly determine that it had jurisdiction to order arbitration of the Passages' claims under the Federal Arbitration Act?

This area of the law is undergoing rapid and comprehensive change as a result of recent U.S. Supreme court decisions. That Court's decision in *Southland Corp. v. Keating* (1984), 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed 2d 1, conclusively answers this question. In that case, Southland Corporation, the owner and franchisor of 7-Eleven convenience stores, was charged by 7-Eleven franchisees with fraud, oral misrepresentation, breach of contract, breach of fiduciary duty, and violation of state disclosure requirements in its franchise agreements. Southland Corporation appealed the decision of the California Court of Appeals that arbitration clauses in Southland's contract with its franchisees were rendered void by California's Franchise Investment Law, which required judicial consideration of claims brought under it. The Supreme Court reversed. It held that, as interpreted, the California Franchise Investment Law conflicted with the Federal Arbitraton Act and violated the Supremacy Clause. The Court reasoned:

"In enacting Sec. 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the state to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration . . .

"Congress has thus mandated the enforcement of arbitration agreements."

Southland, 465 U.S. at 10. In answer to the argument that claims brought in state court are not subject to the Arbitration Act, the Court stated:

". . . it is clear beyond question that if this suit had been brought as a diversity action in a federal district court, the arbitration clause would have been enforceable. (citations omitted) The interpretation given to the Arbitration Act by the California Supreme Court would therefore encourage and reward forum shopping. We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted. And since the overwhelming proportion of all civil litigation in the country is in the state courts, we cannot believe Congress intended to limit the Arbitration Act to disputes subject only to federal court jurisdiction. Such an interpretation would frustrate congressional intent to place '(a)n arbitration agreement . . . upon the same footing as other contracts, where it belongs.' H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924).

"In creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements."

Southland, 465 U.S. at 15-16. Under *Southland*, a state court clearly has jurisdiction to order arbitration under the Federal Arbitration Act.

We affirm the District Court as to this issue.

II.

Are the arbitration agreements in this case adhesion contracts, and if so, are they unenforceable?

The customer agreement forms signed by the Passages are one-page documents, but they contain a number of complex and technical agreements and promises on the parts of both parties. The arbitration clause, paragraph 14, is printed in the same typeface as the rest of the form. It is one of the longer provisions in the agreement. The

Passages invested a significant amount of money with defendants, and there has been no suggestion that they require protection because they are in any way improvident persons.

The *Southland* opinion does not mandate that all arbitration clauses are enforceable:

"We discern only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract 'evidencing a transaction involving commerce' and such clauses may be revoked upon 'grounds as exist at law or in equity for the revocation of any contract.'"

Southland, 465 U.S. at 10-11. The agreement between the Passages and Prudential clearly involves interstate commerce, since its object was purchase and sale of securities through a public stock exchange.

The Passages contend that the agreement should be declared unenforceable upon "grounds as exist at law or in equity for the revocation of any contract." The Passages argue that this clause is revocable because it appears in a contract of adhesion. They have cited post-Southland cases in which state courts have declared void arbitration and clauses in contracts of adhesion. However, the factual and legal situations in those cases are different from the one here. In *Victoria v. Superior Court* (Cal. 1985), 710 P.2d 833 (patient was sexually assaulted by an orderly), the holding that the arbitration clause would be set aside was based on the Court's determination that the scope of the arbitration clause was unclear, its ambiguity should be interpreted against the hospital-drafter, and it was unlikely that the parties intended the arbitration clause to apply in these circumstances. In *Obstetrics and Gynecologists v. Pepper* (Nev. 1985), 693 P.2d 1259 (gynecology clinic patient suffered cerebral incident while on oral contraceptives), the appellate court upheld the district court's setting aside of an arbitration clause. The appellate court stated the district court had not made findings and conclusions but reasoned that the district court could have found the agreement was an adhesion contract and was not knowingly entered.

The Passages also argue that this Court's opinion in *Anderson v. Baker*, (1982), 196 Mont. 494, 641 P.2d 1035 (adhesion contracts construed against the drafter), and *Transamerica Ins. Co. v. Royle* (1983), 202 Mont. 173, 656 P.2d 820 (insurance policy clause examined using consumer approach), should be extended so that the enforceability of this arbitration clause would be examined from a consumer approach. They contend that under the consumer approach the provision for arbitration should be stricken since it was not clearly established that the Passages were put on notice of the arbitration clauses.

In contrast, the federal courts have held arbitration clauses in brokerage agreements enforceable:

"Contracts of adhesion arise when a standardized form of agreement, usually drafted by the party having superior bargaining power, is presented to a party, whose choice is either to accept or reject the contract without the opportunity to negotiate its terms. (citations omitted.) Here, the investor is faced with an industry wide practice of including Arbitration Clauses in standardized borkerage contracts. As the investor faces the possibility of being excluded from the securities market unless he accepts a contract with such an agreement to arbitrate, such clauses come within the adhesion doctrine. However, mere inequality in bargaining power does not render a contract unenforcible [sic], (citation omitted.) nor are all standardized contracts unenforcible. [sic] (citations omitted) As a consequence of current commercial realities, form forum clauses will control, absent a strong showing it should be set aside. (citation omitted.) For such a contract or clause to be void, it must fall within judicially imposed limits of enforcement. It will not be enforced against the weaker party when it is: (1) not within the reasonable expectations of said party or (2) within the reasonable expectations of the party, but, when considered in its context, is unduly oppressive, unconscionable or against public policy. (citations omitted.)

"Such pre-dispute arbitration agreements are not outside the reasonable expectations of the investor. (citations omitted.) Nor are they contrary to public policy, as indicated by the judicial and legislative presumption favoring arbitration of such disputes. (citations omitted.)"

Finkle and Ross v. A. G. Becker Paribas, Inc. (D.C.N.Y. 1985), 622 F.Supp. 1505, 1511-12.

There is nothing in the record to indicate that the arbitration clause in the client agreement form was not within the parties' reasonable expectations. Nor is there any evidence that the clause is oppressive or unconscionable. The federal caselaw demonstrates that arbitration clauses are common, and may be universal, in brokerage agreements. In *Southland*, which like the present case involved allegations of fraud and misrepresentation, the public policy of enforcement of arbitration clauses was forcefully stated. We conclude that even if the customer agreement form is an adhesion contract, there is nothing in the record and no compelling law to prevent enforcement of the arbitration clause. We affirm the District Court's holding that the arbitration clause is enforceable.

III.

Did the District Court err in directing that arbitration be conducted under the rules of the American Arbitraton Association?

The Murray defendants argue that the Passages' election of arbitration rules should not be honored, since they did not consent to arbitration. The Passages' April 16, 1985 election of the American Arbitration Association was made within the 5 days allowed from the date of demand for arbitration, as required in paragraph 14 of the customer agreement form. The selection complied in all respects with the requirements of the contract, but was made contingent upon arbitration being compelled by the court. We conclude that the District Court properly honored the Passages' election of arbitration rules, once it determined that arbitration was proper.

IV.

Which parties are entitled to benefit of the arbitration agreement?

The District Court found the Murray defendants were not signatories to the customer agreement forms. It therefore denied the Murray defendants' motion to compel arbitration. An examination of the customer agreements reveals that Prudential was not a signatory either although its name or the name of its predecessor in interest was printed at the top of each of the forms. The customer agreement

form does not clearly indicate the identity of the party or parties with whom the Passages were contracting; it refers to "you", with no explanation of who "you" is. The District Court granted Prudential's motion to compel arbitration.

All of the claims in the Passages' complaint relate to mishandling or unwise management of the Passages' accounts opened at the G.T. Murray office. It is our conclusion that since the claims against Prudential and against the Murray defendants arise out of the same facts and the same actions, to separate the claims as to the defendants would be inappropriate. There is support for this conclusion:

"Ross (the investor) argues that her claims should not be arbitrated for several reasons. First, she argues that the claims against Mathis (the broker) should not be arbitrated because he is not a party to the agreement. Although Mathis did not sign the agreement, the causes of action against him may be arbitrated. Every allegation against him arises out of his handling of Ross' account as a Bear Stearns employee. Her damages are predicated on Mathis' alleged breach of a myriad of state and federal duties concerning her account at Bear Stearns. Ross' assertions based upon her trust in Mathis due to their relationship do not change this fact. Any breach of trust dealt with Mathis' actions regarding Ross' accounts with Bear Stearns. Thus, her case against Mathis is based solely on her account, which the arbitration agreement covers."

Ross v. Mathis. (N.D.Ga. 1985), 624 F.Supp. 110, 113-14. That Court held that the claims against broker Mr. Mathis were arbitrable.

We hold that the Passages' claims against all of the defendants are arbitrable.

V.

Did the District Court properly stay the claims of the children pending arbitraton of their parents' claims?

Both Prudential and the Passages object to the District Court's order staying the claims on the Passage children's account pending arbitration of the other claims. Prudential argues that the claims on the Passage children's accounts are subject to arbitration along with

the other claims. The Passages argue that the District Court was correct in finding the children's accounts were not included under the terms of the client agreement forms. The contend, however, that it is unjust to stay court action on the children's claims.

Neva Passage opened the accounts in the names of the children and deposited all funds into them. The children are teenagers, and the daughter has attained the age of majority during the course of this action. The amounts deposited in the children's accounts are not large in comparison with the deposits to the other accounts. There is nothing in the record to conclusively establish the nature of these accounts, whether as completed gifts, funds held in trust, or otherwise. The Passages' complaint states that Larry and Neva Passage are 'guardians' of their children but no facts are known as to the technical or legal aspects of the guardian status. We conclude that a factual question remains as to whether Larry and Neva Passage have an interest in the children's accounts, subjecting the accounts to the arbitration agreement.

Issues which go to the formation of the contract as a whole may properly be decided by an arbitrator. *Merrill Lynch, Pierce, Fenner, etc. v. Haydu* (5th Cir. 1981), 637 F.2d 391, 398. We have here an issue of whether the children's accounts are covered by the customer agreement forms. We reverse the order of the District Court on this issue. The District Court shall enter an order submittting this issue to arbitration.

Affirmed in part and reversed in part.
Fred J. Weber, J.

We concur:

J.A. Turnage, C.J.
John Conway Harrison, J.
L. C. Gulbranson, J.
John Sheehy, J.
William E. Hunt, J.

* * * * *

Mr. Justice Morrison dissenting:

I dissent.

The majority opinion concludes that it is not necessary to decide whether the contract is one of adhesion since there is "no compelling

law and nothing in the record to prevent the clause from being enforced." I am at a loss to understand what is being said.

First, it is necessary to decide whether the provision is one of adhesion. Under the authority cited in the majority opinion, the language is clearly one of adhesion since the investor does face the possibility of being excluded from the securities market unless he or she accepts a contract with such an agreement to arbitrate.

Since this provision is one of adhesion the authorities universally require that it not be enforced unless there is a showing that: (1) the provision is within the reasonable expectations of the parties and (2) is not unduly oppressive, unconscionable or against public policy. *Finkle and Ross v. A.G. Becker Paribas, Inc.* (D.C.N.Y. 1985), 622 F.Supp. 1505, 1511-12, cited [in] the majority opinion.

There has been no factual determination by the trial court respecting the reasonable expectations of the parties to this agreement. The adhesion provision provided:

"Any controversy arising out of or relating to my account, to transactions with or for me or to this agreement or the breach thereof . . . shall be settled by arbitration in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchange as I may elect . . ."

First, the adhesion provision is not specifically directed to anyone in particular. We do not know whether the Passages intended for the arbitration agreement to apply to Prudential-Bache, or G.T. Murray, or both. The District Court found that the agreement applied to Prudential-Bache but not to G.T. Murray. The majority finds that the District Court erred in that it would be inappropriate to separate the claims as to the defendants. This action is taken by the majority with no reference to whether application of arbitration to the Murray defendants was within "the reasonable expectations" of the parties. This is a factual determination that was not clearly addressed by the District Court but, if it was addressed, the District Court must have found that Passages did not expect the agreement to apply to Murrays. There is no factual basis for this appellate court to find that the record shows, as a matter of law, that the parties intended the

arbitration clause to run to Murrays who are not mentioned in the agreement.

Secondly, there are no facts in the record respecting whether Passages intended the arbitration provision to apply to tort actions. Domke on Commercial Arbitration (Rev. Ed.) states at Sec. 13:08 that:

"Liability for tort will usually not be an arbitrable issue since parties will hardly have contemplated such occurrance when they made an agreement containing an arbitration clause. Since events of a tortious character are usually not foreseen, such events will not be specifically included in the arbitration agreement so as to later come (sic) arbitrable issues."

Again, we have no factual determination by the trial court about whether it was within the reasonable expectaton of the parties that tort claims would be submitted to arbitration. As indicated by Domke such claims are usually not embraced within arbitration agreements and there would have to be evidence to the contrary showing that the parties did in fact intend to include tort claims within the arbitration provision.

The most amazing aspect of the majority opinion is the position that the issue of whether children's accounts are included within the arbitration provision is a fact to be determined by arbitration. What a quantum leap in logic.!

The children have a right to court access for resolution of their claims unless they have validly relinquished that right through executing an arbitration provision. Whether such contractual consent existed is a factual determination for the District Court. The District Court apparently held the children had not relinquished their rights for court access. The majority begins by denying court access in allowing an arbitrator to decide a factual question that necessarily requires court resolution first. How could the children's rights be decided by an arbitrator unless they first validly relinquished their right to a judicial determination?

This case should be remanded for factual findings as indicated.

Frank B. Morrison Jr.

APPENDIX B

IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK.

LARRY W. PASSAGE et al.,

Plaintiffs

v.

PRUDENTIAL BACHE SECURITIES, et al.

Defendants,

No. 85-176

ORDER AND OPINION

Plaintiffs charge defendants with violation of the Montana securities statute and New York Stock Exchange rules and regulations, breach of contract and fiduciary duty, constructive fraud and failure to supervise in connection with the loss of more than $320,000 of their invested monies. Defendants have moved for an order compelling arbitration of all state law claims presented in plaintiffs' petition. Plaintiffs resist. Following hearing and briefing the matter was submitted May 24, 1985.

Larry Passage opened his accounts with G. T. Murray Company (Murray Co.) February 1, 1983. Murray Co. is a broker-dealer providing investment advice. It is affiliated with Prudential-Bache Securities, Inc. (Prudential), which is also a broker-dealer that executes orders and carries accounts for customers of Murray Co. These accounts were opened through Defendant Crowley, an employee of

Murray Co. Larry Passage signed a standard client's agreement used by Prudential, Paragraph 14 of which provides in part:

". . . Any controversy arising out of or relating to my account, to transactions with or for me or to this agreement or the breach thereof . . . shall be settled by arbitration in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchange as I may elect. .... Judgment upon any award rendered by the arbitrators may be entered in any court having jurisdiction thereof, without notice to me. "

The agreement pertained to all Mr. Passage's accounts and was expressly governed by the laws of the State of New York. February 1, 1983, Plaintiff Neva M. Passage executed identical agreements for her accounts. August 16, 1983, Plaintiff Twila Passage executed a similar agreement. The other defendants were neither parties nor signatories to any of the agreements in question.

January 7, 1983, Prudential and Murray Co. entered into an agreement which specified the duties and compensation of each with regard to customers' accounts. Murray Co.'s duties under the agreement include investment of customers' money insuring that no transactions are made in violation of any laws or regulations. Prudential's responsibilities include execution of orders and the furnishing of monthly statements. Letters describing these functions were sent on the Murray Co. letterhead to the Plaintiffs. The agreement stated specfically that the arrangement was to be regarded as neither a partnership nor agency relationship.

Purportedly pursuant to the client agreements between the plaintiffs and Prudential, Murray Co. demanded arbitration of Larry, Neva and Twila Passage by certified mail on April 12, 1985. Prudential made a similar demand April 16, 1984.

ANALYSIS

Plaintiffs clearly agreed in writing to arbitrate any claims arising from any of their accounts with Prudential. The issue thus presented by the defendants' motion to compel arbitration are:

1. Whether a party to an agreement which includes an arbitration clause can be compelled to arbitrate issues arising under this state's

securities laws, even if such arbitration agreement violates the state's policy in opposition to enforcement of such an agreement ?

2. Whether a party can be compelled to arbitrate with Murray Co., G. T. Murray, Mr. Crowley or Mr. Dobbins, none of whom were parties to the client agreement containing the arbitration clause?

3. Can arbitration be compelled for the accounts of Allison or Todd Passage, who did not sign agreements?

From 1895 to 1985 every condition in a contract that restricted its enforcement in court was void by statute. (28-2-708) This was always viewed as including agreements to arbitrate. *Ace Plumbing and Heating v. Helena Flats*, 662 P.2d 1327 (1983). This harsh common law prohibition was largely repealed by the 1985 legislature. Sect. 4, Ch. 684, L. 85 provides: A written agreement to submit an existing controversy to arbitration is valid and enforceable . . . ." For some reason 28-2-708 was not repealed by this act but it was rendered essentially toothless. The act applies, however, only to agreements made subsequent to October 1, 1985, and thus could have no effect on the instant litigation. Therefore, the state prohibition against enforcing contractual arbitration agreements is alive and well for the purpose of this opinion.

Defendants' motions to compel arbitration are based on a recent U. S. Supreme Court decision. In *Southland Corporation v. Keating*, 104 S. Ct. 852 (1984), the Court held states have no power to invalidate agreements contained in contracts involving commerce and that such agreements are valid under the Federal Arbitration Act. 9 U.S.C. Sec. 4. The decision reversed a decision of the California Supreme Court denying enforcement of an arbitration agreement in accordance with state law. There are two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: the provisions must be part of a contract evidencing a transaction involving commerce, and they may be revoked upon "grounds as exist at law or in equity for revocation of any contract." *Southland* at 858. In this case there is no dispute that Prudential's handling of these client accounts involves transactions in interstate commerce, it being conceded that Prudential is a foreign corporation.

Plaintiffs contend, however, that the arbitration provisions in question are "contracts of adhesion" and therefore fall within the

second limitation stated in *Southland*, that arbitration clauses may be revoked upon grounds as exist at law or in equity. They claim the contract was adhesive because it was drafted unilaterally by Prudential, the dominant party, and was presented on a take-it-or-leave-it basis to the Passages, the weaker parties, who had no real opportunities to bargain about its terms. It is well settled that contracts of adhesion are not per se illegal but any ambiguities in them are resolved in favor of the party having no voice in arriving at their terms. *Anderson v. Baker*, 641 P.2d 1035 (1982). Here the plaintiffs do not claim any ambiguities in the arbitration clause; rather they claim the court should "closely scrutinize" the contract.

We find plaintiffs reliance on *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238 (1985) for the proposition that such a contract of adhesion is subject to "close scrutiny" to be unpersuasive. Far from reserving any ruling on whether arbitration contracts are contracts of adhesion and therefore subject to close srutiny, the Supreme Court merely "express[ed] no view on the merits of the argument." *Dean Witter*, at 1240, note 2. This case clearly held the Federal Arbitration Act compelled arbitraton of a state securities law claim. Id. at 1244.

Accordingly we find the *Southland* decision applicable in this case. There is no question that the legal claims are within the scope of the arbitration provisions. A contract involving interstate commerce exists and there are no grounds in law or equity for its revocation. Therefore, in spite of Montana's ancient public policy disfavoring contracts for arbitration of future disputes, we conclude the arbitration agreement is valid and requires this court to compel arbitration between the proper parties according to the Federal Arbitration Act.

Plaintiffs further question whether Murray Co., G. T. Murray, Dobbins and Crowley have standing to demand arbitration. Section 34 of the Federal Arbitration Act provides:

" . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.... If the making of the arbitration agreement

or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof...."

Whether a person is a party to [an] arbitration agreement is included within the statutory issue of "the making of the arbitration agreement." *Hartford Fin Systems v. Florida Software Service, Inc.*, 550 F.Supp. 1079, 1086 (1982). By asserting that Murray Co., G. T. Murray, Dobbins and Crowley are not parties to the arbitration agreement, plaintiffs themselves place the "making of the arbitration agreement" at issue. In this case, however, Prudential, one of the signatories of the agreement, also has demanded arbitration on the claims of the plaintiffs. There can be no question that Prudential has standing to make such a demand and place the question at issue. It is therefore immaterial whether the four other defendants have standing to do so.

The final issue raised by defendants' motion to compel arbitration is whether the client agreements apply to the accounts of Todd and Allison Passage, the minor children of Neva Passage. Neither Todd nor Allison signed or entered into the agreements. No demands for arbitration have been made conerning these accounts, but defendants claim the motion to compel arbitration applies because their mother, who opened other accounts subject to arbitration, opened the accounts for the children. They argue that by opening these accounts Neva Passage had an "interest" in her childrens' accounts and that interest subjects these account to arbitration under the language of her signed client agreements: "I agree as follows with respect to all of my accounts, in which I have an interest alone or with others...."

We find no authority for defendants' proposition. Montana statutes make it clear that parents have no authority or control over their children's property (40-6-232). A parent cannot contract with respect to the child's property and a minor connot delegate this power. (41-1-301) Neither parents have authority to compromise or release claims or causes of action belonging to their children unless they have been appointed guardian. In this case Neva is a custodian for the accounts of Todd and Allison, but she has not been appointed guardian. Because an arbitration agreement is a waiver of the right to bring an action in court, Neva Passage was without authority to waive the children's (sic) right to bring their claims before the court.

We therefore conclude the client agreements signed by Neva Passage did not apply to accounts opened on behalf of Todd and Allison Passage. We find, however, that further judicial proceedings on the claims arising from Todd's and Allison's accounts should be stayed until arbitration is completed on the other Passage claims.

Any other issues arising from the client agreement itself, such as the applicability of laws of New York or the extent of damages may be settled in arbitration. *Cone Memorial Hospital v. Mercury Construction*, 103 S.Ct. 927, 941 (1983).

Accordingly, we grant Prudential's motion to compel arbitration and deny the motion of Defendants Murray Co., G. T. Murray, Mr. Dobbins and Mr. Crowley. We order arbitration of plaintiffs' claims to be conducted in accordance with the rules of the American Arbitration Association, as elected by the plaintiffs. Further proceedings in this Court will be stayed pending outcome of the arbitration.

Dated this 19th day of August, 1985

Gordon R. Bennett
District Judge

Bache Halsey Stuart Shields Incorporated CLIENT'S AGREEMENT	ACCOUNT NAME (HEREIN REFERRED TO AS I) Neva M. Passage	ACCOUNT NO. CP-00674-09	DOC ID. 42	DATE 2/1/83

1. I agree as follows with respect to all of my accounts, in which I have an interest alone or with others, which I have opened or open in the future, with you for the purchase and sale of securities and commodities:

2. I am of full age and represent that I am not an employee of any exchange or of a Member Firm of any Exchange or the NASD, or of a bank, trust company, or insurance company and that I will promptly notify you if I become so employed.

3. All transactions for my account shall be subject to the constitution, rules, regulations, customs and usages, as the same may be constituted from time to time, of the exchange or market (and its clearing house, if any) where executed.

4. Any and all credit balances, securities, commodities or contracts relating thereto, and all other property of whatsoever kind belonging to me or in which I may have an interest held by you or carried for my accounts shall be subject to a general lien for the discharge of my obligations to you (including unmatured and contingent obligations) however arising and without regard to whether or not you have made advances with respect to such property and without notice to me may be carried in your general loans and all securities may be pledged, repledged, hypothecated or re-hypothecated, separately or in common with other securities or any other property, for the sum due to you thereon or for a greater sum and without retaining in your possession and control for delivery a like amount of similar securities or other property. At any time and from time to time you may, in your discretion, without notice to me, apply and/or transfer any securities, commodities, contracts relating thereto, cash or any other property therein, interchangeably between any of my accounts, whether individual or joint or from any of my accounts to any account guaranteed by me. You are specifically authorized to transfer to my cash account on the settlement day following a purchase made in that account, excess funds available in any of my other accounts, including but not limited to any free balances in any margin account or in any non-regulated commodities account, sufficient to make full payment of this cash purchase. I agree that any debit occurring in any of my accounts may be transferred by you at your option to my margin account.

5. I will maintain such margins as you may in your discretion require from time to time and will pay on demand any debit balance owing with respect to any of my accounts. Whenever in your discretion you deem it desirable for your protection, (and without the necessity of a margin call) including but not limited to an instance where a petition in bankruptcy or for the appointment of a receiver is filed by or against me, or an attachment is levied against my account, or in the event of notice of my death or incapacity, or in compliance with the orders of any Exchange, you may, without prior demand, tender, and without any notice of the time or place of sale, all of which are expressly waived, sell any or all securities, or commodities or contracts relating thereto which may be in your possession, or which you may be carrying for me, or buy any securities, or commodities or contracts relating thereto of which my account or accounts may be short, in order to close out in whole or in part any commitment in my behalf or you may place stop orders with respects to such securities or commodities and such sale or purchase may be made at your discretion on any Exchange or other market where such business is then transacted, or at public auction or private sale, with or without advertising and neither any demands, calls, tenders or notices which you may make or give in any one or more instances nor any prior course of conduct or dealings between us shall invalidate the aforesaid waivers on my part. You shall have the right to purchase for your own account any or all of the aforesaid property at any such sale, discharged of any right of redemption, which is hereby waived.

6. All orders for the purchase or sale of commodities for future delivery may be closed out by you as and when authorized or required by the Exchange where made. Against a "long" position in any commodity contract, prior to maturity thereof, and at least five business days before the first notice day of the delivery month, I will give instructions to liquidate, or place you in sufficient funds to take delivery; and in default thereof, or in the event such liquidating instructions cannot be executed under prevailing conditions, you may, without notice or demand, close out the contracts or take delivery and dispose of the commodity upon any terms and by any method which may be feasible. Against a "short" position in any commodity contract, prior to maturity thereof, and at least five business days before the last trading day of the delivery month, I will give you instructions to cover, or furnish you with all necessary delivery documents; and in default thereof, you may without demand or notice, cover the contracts, or if orders to buy in such contracts cannot be executed under prevailing conditions, you may procure the actual commodity and make delivery thereof upon any terms and by any method which may be feasible.

7. All transactions in any of my accounts are to be paid for or required margin deposited no later than 2:00 p.m. on the settlement date.

8. I agree to pay interest and service charges upon my accounts monthly at the prevailing rate as determined by you.

9. I agree that, in giving orders to sell, all "short" sale orders will be designated as "short" and all "long" sale orders will be designated as "long" and that the designation of a sell order as "long" is a representation on my part that I own the security and, if the security is not in your possession that it is not then possible to deliver the security to you forthwith and I will deliver it on or before the settlement date.

10. Reports of the execution of orders and statements of my account shall be conclusive if not objected to in writing within five days and ten days, respectively, after transmittal to me by mail or otherwise.

11. All communications including margin calls may be sent to me at my address given you, or at such other address as I may hereafter give you in writing, and all communications so sent, whether in writing or otherwise, shall be deemed given to me personally, whether actually received or not.

12. No waiver of any provision of this agreement shall be deemed a waiver of any other provision, nor a continuing waiver of the provision or provisions so waived.

13. I understand that no provision of this agreement can be amended or waived except in writing signed by an officer of your Company, and that this agreement shall continue in force until its termination by me is acknowledged in writing by an officer of your Company; or until written notice of termination by you shall have been mailed to me at my address last given you.

14. This contract shall be governed by the laws of the State of New York, and shall inure to the benefit of your successors and assigns, and shall be binding on the undersigned, his heirs, executors, administrators and assigns. Any controversy arising out of or relating to my account, to transactions with or for me or to this Agreement or the breach thereof, and whether executed or to be executed within or outside of the United States, except for any controversy arising out of or relating to transactions in commodities or contracts related thereto executed on or subject to the rules of a contract market designated as such under the Commodity Exchange Act, as amended, shall be settled by arbitration in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchange as I may elect. If I do not make such election by registered mail addressed to you at your main office within five (5) days after demand by you that I make such election, then you may make such election. Notice preliminary to, in conjunction with, or incident to such arbitration proceeding, may be sent to me by mail and personal service is hereby waived. Judgment upon any award rendered by the arbitrators may be entered in any court having jurisdiction thereof, without notice to me.

15. If any provision hereof is or at any time should become inconsistent with any present or future law, rule or regulation of any securities or commodities exchange or of any sovereign government or a regulatory body thereof and if any of these bodies have jurisdiction over the subject matter of this agreement, said provision shall be deemed to be superseded or modified to conform to such law, rule or regulation, but in all other respects this agreement shall continue and remain in full force and effect.

DATE 2/1/83 CLIENT'S SIGNATURE X Neva M. Passage X

(P)

SIGN IN BOTH PLACES

LENDING AGREEMENT

YOU AND ANY FIRM SUCCEEDING TO YOUR FIRM ARE HEREBY AUTHORIZED FROM TIME TO TIME TO LEND SEPARATELY OR TOGETHER WITH THE PROPERTY OF OTHERS EITHER TO YOURSELVES OR TO OTHERS ANY PROPERTY WHICH YOU MAY BE CARRYING FOR ME ON MARGIN. THIS AUTHORIZATION SHALL APPLY TO ALL ACCOUNTS CARRIED BY YOU FOR ME AND SHALL REMAIN IN FULL FORCE UNTIL WRITTEN NOTICE OF REVOCATION IS RECEIVED BY YOU AT YOUR PRINCIPAL OFFICE IN NEW YORK.

DATE 2/1/83 CLIENT'S SIGNATURE X Neva M. Passage X

KINDLY SIGN THIS FORM IN THE TWO SIGNATURE SPACES INDICATED ABOVE. IN THE CASE OF JOINT ACCOUNTS, BOTH TENANTS SHOULD SIGN IN BOTH SIGNATURE SPACES. RETURN THIS ORIGINAL (WHITE) TO THE BACHE OFFICE WHICH SERVICES YOUR ACCOUNT. THE DUPLICATE IS RETAINED FOR YOUR PERSONAL RECORDS.

FORM 1010A

EXHIBIT D

BEST AVAILABLE COPY

Supreme Court, U.S.
FILED
DEC 20 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-887

In the Supreme Court

of the United States

OCTOBER TERM, 1986

LARRY W. PASSAGE, et al., *Petitioners,*

v.

PRUDENTIAL-BACHE SECURITIES, INC., et al., *Respondents.*

BRIEF OF RESPONDENTS G.T. MURRAY, WILLIAM CROWLEY, RICHARD DOBBINS, G.T. MURRAY & CO., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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United States Supreme Court Rule 17 5

No. _____

In the Supreme Court

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OCTOBER TERM, 1986

LARRY W. PASSAGE, et al., *Petitioners,*

v.

PRUDENTIAL-BACHE SECURITIES, INC., et al.,
Respondents.

BRIEF OF RESPONDENTS G.T. MURRAY, WILLIAM CROWLEY, RICHARD DOBBINS, G.T. MURRAY & CO., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

The Respondents, G.T. Murray, William Crowley, Richard Dobbins, G.T. Murray & Co., respectfully pray that this court deny issuance of a writ of certiorari to review the udgment and opinion of the Supreme Court of Montana in the above matter.

OPINIONS BELOW AND JURISDICTION

Respondents agree that the opinions below are as set forth in the petition and Respondents agree with the jurisdictional statement in the petition.

QUESTION PRESENTED

Respondents accept the question presented although the opinions below did not find the contract in question to be adhesive or the arbitration clause itself to be adhesive.

STATUTORY PROVISIONS INVOLVED

Respondents agree that Petitioners have set forth in their petition 9 U.S.C. § 2 which is involved in this matter but contend 17 C.F.R. § 240.15C2-2 is not applicable since Petitioners in their action did not allege any violations of Federal securities statutes but instead brought this action under Montana state statutes in a state district court. This section of the Code of Federal Regulations has no relevance with regard to arbitration of state securities law actions.

STATEMENT OF THE CASE

Petitioners have accurately stated the case in their petition except that the statement should be amplified to include the facts that no evidence was ever introduced by affidavit or otherwise that Petitioners did not read the contract in question, including the challenged arbitration clause, or that Petitioners failed to understand the import or consequences of executing such contract or that Petitioners ever took exception in any form to such contract or arbitration clause. For that matter no argument to this effect was ever made by Petitioners.

PRESERVATION OF THE QUESTION RAISED FOR REVIEW

The initial appeal of the district court's opinion was filed by Respondents. Petitioners and Prudential Bache cross appealed.

Petitioners cross appealed, in part, on the issue "are 'adhesion contracts' to arbitrate routinely enforceable?"

REASONS FOR DENYING THE WRIT

1. NO SUBSTANTIAL FEDERAL QUESTION IS INVOLVED

Under United States Supreme Court Rule 17 concerning considerations governing review on certiorari this court will grant certiorari only when there are special and important reasons therefore. Included in such reasons under the rule are:

> "(b) When a state court of last resort has decided a federal question in a way in conflict with the decision of another state court of last resort or a federal court of appeals.
>
> "(c) When a state court or a federal court of appeals has decided an important question of federal law which has not been, but should be, settled by this court, or has decided a federal question in a way in conflict with applicable decisions of this court."

To Respondents' knowledge no state or federal court has held the securities brokers contracts in question to be unenforceable under adhesion theories. The question has been considered by federal courts in several circuits and unenforceability because of asserted adhesion theories denied. *See e.g. Rush v. Oppenheimer & Co., Inc.*, 638 F. Supp. 872 (S.D. N.Y. 1986); *Surman v. Merrill Lynch*, 733 F.2d 59, 61 n.2 (8th Cir. 1984); *Brener v. A.G. Becker Paribas, Inc.*, 628 F.Supp. 442 (S.D. N.Y. 1985); *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334, 339 (7th Cir. 1984); *Tinkle and Ross v. A.G. Becker Paribas, Inc.*, 622 F.Supp. 1505 (D.C. N.Y. 1985). The decision of the Montana Supreme Court in this case does not conflict with any decision of this court. The extensive consideration of arbitration provisions in brokers' contracts by this Court and the universal treatment of the question in at least several federal decisions from various circuits refutes the importance of the question

presented in the request for a writ. Issuance of the writ should therefore be denied.

2. THE MONTANA SUPREME COURT FULLY CONSIDERED THE ISSUES PRESENTED HERE AND DECIDED THE SAME CORRECTLY.

The Montana Supreme Court fully considered the issues presented here and decided the same correctly relying on this Court's strong approval of such agreements in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), as did the district court. The court found that the Petitioners invested a significant amount of money with Respondents and there has been no suggestion they require protection because they are in any way improvident persons. App. 5. The court correctly analyzed *Southland's* requirement that there are only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a "contract evidencing a transaction involving commerce" and such clause may be revoked upon "grounds as exist at law or equity for the revocation of any contract." App. 5. In concluding that such arbitration agreements are not outside the reasonable expectations of the investor nor are they contrary to public policy, as indicated by the judicial and legislative presumption favoring arbitration of such disputes, the court found the arbitration clause in this case was within the reasonable expectations of the parties nor is there any evidence that the clause is oppressive or unreasonable. App. 7. Thus, the Court found, as federal courts in several circuits have found, such clauses are not revocable upon "grounds as exist at law or equity for the revocation of any contract." In reaching its decision on this issue the court stated:

> "In *Southland*, which like the present case involved allegations of fraud and misrepresentation, the public policy of enforcement of arbitration clauses was forcefully stated. We conclude that even if a customer agreement form is an adhesion contract, there is nothing on the record and no compelling law

> to prevent enforcement of the arbitration clause. We affirm the district court's holding that the arbitration clause is enforceable."

App. 7.

The Montana Supreme Court therefore fully considered the issues present here and under its analysis of *Southland* reached the correct result.

CONCLUSION

For these reasons, a writ of certiorari to review the judgment and opinion of the Supreme Court of Montana should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Michael J. Mulroney, hereby certify that on this _____ day of December, 1986, three copies of the Brief of Respondents G.T. Murray, William Crowley, Richard Dobbins, G.T. Murray & Co., in Opposition to Petition for Writ of Certiorari were mailed, postage prepaid, to:

Mr. W. William Leaphart, Leaphart Law Firm, 1 North Last Chance Gulch, Helena, MT 59601, counsel for the Petitioners.

Mr. Dan Shea, at 800 Broadway, Helena, MT 59601, counsel for Prudential-Bache Securities.

I further certify that all parties required to be served have been served.

Michael J. Mulroney

Supreme Court, U.S.
FILED
JAN 22 1987
JOSEPH F. SPANIOL, JR.
CLERK

(3)

No. 86-887

In the Supreme Court

of the United States

OCTOBER TERM, 1986

LARRY W. PASSAGE, et al., Petitioners,

v.

PRUDENTIAL-BACHE SECURITIES, INC., et al.,
Respondents,

BRIEF OF RESPONDENTS, PRUDENTIAL-BACHE SECURITIES, INC., et al, RESPONDENTS

Daniel J. Shea
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16 pp

QUESTIONS PRESENTED

Before this court reaches a decision as to whether there should be review on the merits, Prudential-Bache asks this Court to determine whether the question raised by the Petitioners is properly before this Court. The question raised here by Petitioners here was not decided by either the Montana trial court or the Montana Supreme Court. Furthermore, if Petitioners did raise the question before the Montana Supreme Court, they did not preserve the question by filing a petition for rehearing and asking the Montana Supreme Court to expressly rule on this question.

If we assume the question is properly before this Court, Prudential-Bache does not agree with the question presented by the Petition. The question should be whether the Fifth Amendment Due Process Clause prevents the National Arbitration Act from being enforced if an agreement to arbitrate does not expressly set out the rights that are given up by submitting a dispute to arbitration. This Court should refuse to issue a writ of certiorari because the question raised does not present a substantial federal question.

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(1) Clarification of the record as to whether Prudential-Bache conceded the agreements were adhesion contracts

(2) Failure to Preserve the Question Raised for Review

(a) Neither the Montana trial court nor the Montana Supreme Court ruled on the question presented to this Court in the Petition for Certiorari.

(b) If we assume the question as presented to this Court was properly raised before the Montana trial court and the Montana Supreme Court, both courts nonetheless did not rule on the issue and Petitioners failed to preserve the issue by filing a petition for rehearing asking the Montana Supreme Court to directly rule on the question.

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(1) The question presented to this Court was not iii

directly presented to the trial court or to the Montana Court, and as a result neither the trial court nor the Montan Supreme Court ruled on the question.

(2) If we assume the question presented in the Petition for Certiorari was raised before the trial court and again before the Montana Supreme Court, the Petitioners failed to preserve the issue by asking the Montana Supreme Court through a petition for rehearing, to directly rule on the question. The result is that there is no ruling by the Montana Supreme Court on the question raised in the Petition before this Court.

(3) The question does not present a substantial federal question

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No. _____

In the Supreme Court

of the United States

OCTOBER TERM, 1986

LARRY W. PASSAGE, et al., Petitioners,

v.

PRUDENTIAL-BACHE SECURITIES, INC., et al.,
Respondents,

BRIEF OF RESPONDENT PRUDENTIAL-BACHE SECURITIES, INC., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

The respondent, Prudential-Bache Securities, Inc., respectfully prays that this court deny issuance of a writ of certiorari to review the judgement and opinion of the Supreme Court of Montana in the above matter.

JURISDICTION

Respondent Prudential-Bache agrees that the petition for certiorari was timely filed and that this court has jurisdiction under 28 U.S.C. Sec 1257 (3). We argue below, however, that the Petition for Certiorari should be dismissed.

QUESTIONS PRESENTED

Before this Court reaches a decision as to whether there should be review on the merits, Prudential-Bache asks this Court to determine whether the issue raised by the Petitioner is properly before this Court. The issue raised by Petitioners here was not decided by either the Montana trial court or the Montana Supreme Court. Furthermore, if Petitioners did raise the issue before the Montana Supreme Court, they did not preserve the issue by filing a petition for rehearing and asking the Montana Supreme Court to expressly rule on this issue.

If we assume the question is properly before this Court, we do not agree with the question presented by the Petition. The question should be whether the Fifth Amendment Due Process Clause prevents the National Arbitration Act from being enforced if the agreement to arbitrate does not expressly set out the rights that are given up by agreeing to arbitration.

STATUTORY PROVISIONS INVOLVED

We agree that Petitioners have set forth in their petition the basic statute on which arbitration turns where the transaction involves interstate commerce--9 U.S.C. 2. However, we agree with Respondents G.T. Murray & Co., et al, that the Petitioners have improperly relied on 17 C.F.R. 240.15C2-2. It has no application to this case.

Respondent Prudential-Bache also relies on Rule 34 of the

Montana Rules of Appellate Civil Procedure. It provides:

> Rule 34. Petitions for rehearing.
> When, in appeals or special proceddings, it is ordered that remittitur, peremptory writ of judgment issue forthwiht, no petition for rehearing will be entertained. In all other cases a petition for rehearing may be filed within 10 days after the decision of the supreme court has been rendered, unless the time is shortened or enlarged by order, and the adverse party shall have 7 days thereafter in which to serve and file his objections thereto. Extensions of time will be granted only upon showing of unusual merit, and in no event in excess of 10 days. A petition for rehearing may be presented upon the following grounds and none other: That some fact, material to the decision, or some question decisive of the case submitted by counsel, was overlooked by the court, or that the decision is in conflict with an express statute or controlling decision to which the attention of the court was not directed. Oral argument in support of the petition will not be permitted. Six copies of the petition and six copies of objections thereto, which may be in typewritten form, shall be filed with the clerk.

STATEMENT OF THE CASE

Several matters must be cleared up regarding Petitioners' Statement of the Case. First, Prudential-Bache did not concede the agreements to be adhesion contracts. Second, in discussing the question of whether the question had been preserved for review the Petitioners" state that the trial court found that the Passages had "unknowingly" given up enormous discovery rights. There is no finding to this effect and there is not a scrap of evidence in the record that the Passages were unaware of what discovery rights they may have given up by agreeing to arbitration. Third, contrary to the assertions of the Petitioners, the question was not preserved for review either at the trial court level or before the Montana Supreme Court. Furthermore, neither court ruled on the question that is presented to this Court by the

petition for a writ of certiorari.

First, contrary to the assertion of the Petitioners, Prudential-Bache did not concede the agreements to be adhesion contracts. Petitioners cite but do not quote from the transcript (Tr. 32). In the proceedings before the trial court this counsel did indicate the agreements perhaps were of the take it or leave it kind, but qualified this statement by stating he had no experience in this area and really did not know. In concededly inartful language, I stated:

> . . . I don't really know whether Prudential or G.T. Murray or anyone else would refuse to enter into an agreement and we don't like this provision as to arbitration. I don't know--I don't have any experience. (Tr. 32)

The colloquy at page 48 of the transcript possibly supports the conclusion that the trial court believed that all the defendants had agreed the documents to be contracts of adhesion, but even the trial court was not satisfied of this fact. (Tr. 48) We emphasize this point only to establish that Prudential-Bache did not concede the documents to be contracts of adhesion.

Second, the Petitioners point of emphasizing that the trial court concluded the Passages had "unknowingly" given up enormous discovery rights, is apparently presented to this Court to support the proposition that the Passages did not understand the purport of the arbitration agreements. But there is not a scrap of evidence to support this conclusion as to the state of mind of the Passages in signing the arbitration agreements. The fact that they at no time alleged they did not read the arbitration agreements and not time alleged they did not understand the effect of the arbitration agreements, would seem to establish that they were fully aware of what they were doing when they signed the contracts.

Third, and most important on the question of whether this Court, under Rule 21, has jurisdiction to take the case on the merits and decide the question presented, the Passages are utterly wrong in asserting that they presented the question to the Montana courts and that the Montana courts decided the question. Neither the Montana trial court nor the Montana

Supreme Court decided the question presented in this Petition. For this reason the Petitioners have failed to fulfill the requirements of Rule 21 and the Petition should be dismissed.

If the question was raised in the Montana trial court it was done in such fashion that all of the opposing counsel and the trial court failed to realize that it had been raised. The question was not briefed by opposing counsel in trial court, and the trial court's opinion (see Petitioners' Appendix B, pp13-15) fails to even mention, let alone decide the question presented here.

The same is true in the proceedings before the Montana Supreme Court . The question was not squarely raised in the Passages' briefs filed before the Montana Supreme Court, and this being so, all briefs in opposition did not discuss the question now before this Court. More important, the question before this Court was not decided by the Montana Supreme Court in its opinion renderd on August 26, 1986. In fact, the issue was not even mentioned. (See opinion in Petitioners' Appendix A, pp4-7.)

Finally, the Petitioners failed to avail themselves of a final opportunity to rule on the question if it was indeed raised at all. Rule 34 of the Montana Rules of Appellate Civil procedure permits a party to petition the Montana Supreme Court for a rehearing if it feels that" . . . some question decisive of the case, was overlooked by the court . . ." If the Passages squarely presented this issue to the Montana Supreme Court in the petition for rehearing and convinced the Court that the issue had been raised in the appeal, it is quite possible the Court would have granted a rehearing and decided the question. But the Passages failed to do so, and the result, now, is that there is no clear record indicating that the question was squarely raised in the Montana Supreme Court. And it is beyond question the question was never decided.

ARGUMENT

The Petitioners' contention seems to be fashioned out of

thin air. They at no time alleged they did not read the arbitration agreements. They at no time alleged they did not understand the arbitration agreements. And they at no time alleged they did not know what rights they were giving up by signing the agreements. Because of this we must assume they knew what they were doing. However, they are now asking this Court to rule straight across the board that to be enforceable under the National Arbitration act, all arbitration contracts must expressly set out all rights that are given up by submitting a dispute to arbitration. Even assuming some validity to this contention, this Court should refuse to hear the case of the merits because this issue was never squarely raised before the Montana trial court or before the Montana Supreme Court. As a result neither of these Courts ruled on this question.

At the trial court level neither Prudential-Bache nor the G.T. Murray & Co. defendants disscussed the question now before this Court. If the question was raised in the trial court it was so obscurely raised that neither the defendants nor the arbitration agreements can be enforced, the Montana trial court stated the issue as follows: "Whether a party to an agreement which includes an arbitration clause can be compelled to arbitrate issues arising under this state's securities laws, enen if such arbitration agreement violates the state's policy in opposition to enforcement of such an agreement?" (See Petitioners' Appendix B, at 14). The trial court's discussion of this issue immediately following the statement of this issue is barren of any mention of the question that Petitioners have raised before this Court in their Petition for a Writ of Certiorari.

The same is true of the proceedings before the Supreme Court of Montana. If the question was raised before the Montana Court it was done so obscurely that Prudential-Bache and the G.T. Murray & Co. defendants did not realize it had been raised. In their briefs raising the contracts of adhesion issue before the Montana Supreme Court the Passages in the table of contents to their brief state that "The arbitration Clauses in Question are Contracts of Adhesion and are thus Unenforceable." This identical language is repeated at page 7 of their brief where the Passages begin discussion of the contracts of adhesion

issue. Not until 5 pages later, at page 12 is there any suggestion that Passages are attacking the National Arbitration Act as being unconstitutional. The Passages declare: "as applied to the contracts in question, the National Arbitration Act is unconstitutional."

If this bare reference raised the question of constitutionality of the National Arbitration Act as applied to the contracts in question here, neither the opposing parties nor the Supreme Court of Montana realized that it had been raised. As a result, the opinion of the Supreme Court of Montana is similarly barren of any discussion of this issue--and most certainly the issue was not ruled upon.

In setting out the issue concerning the alleged adhesion contracts, the Supreme Court stated:"2. Are the arbitration agreements in this case adhesion contracts, and if so, are they enforceable." (See Petitioners' Appendix A, pp4-7). There is not one reference to any claim of the Passages that they were claiming the National Arbitration Act to be unconstitutional as applied or in any other way. The Supreme Court of Montana clearly did not rule on the issue. The question raised should not be heard on the merits because neither the Montana trial court nor the Montana Supreme Court ruled on the question raised in the Petition.

Under Rule 21 of this Court governing Petitions for a Writ of Certiorari, if is the burden of the Petitioners here to establish just how they raised the question in both the trial court and before the Montana Supreme Court. It is also their burden to establish precisely how both the trial court and the Montana Supreme Court ruled on the question for which review by this Court is sought. The Petitioners did not do so.

The petition does not even attempt to establish that the Montana trial court passed on the question for which review is now being sought. (See Petitioners' Petition, page 4). And though Petitioners attempt to establish that they raised the constitutional isue before the Montana Supreme Court (see Petitioners' Petition pages 4-5), they do not establish that the Montana Supreme Court ruled on the question presented her

In attempting to establish that the Montana Supreme Court ruled on the question the Petitioners attempt to summarize the holding by stating: "The Supreme Court of Montana found the arbitration clauses enforceable, noting that such classes are 'universal' and that there was no evidence the clauses were unconscionable." (Petitioners' Petition, at 5.) This summary fails to establish that the Montana Supreme Court ruled on the question presented in the Petition. Indisputably, the Montana Supreme Court did not rule on this question (see Appendix A to Petitioners' Petition, pp. 4-7).

Finally, we note that if the Petitioners thought they had raised the issue before the Montana Supreme Court, but that it had not been ruled upon, it was their right to petition the Montana Supreme Court for a rehearing under Rule 34 to seek a direct ruling on the issue raised. But the petitioners failed to do so. The result is that not only did the Montana Supreme Court not rule on the question presented to this Court, but the Petitioners failed to avail themselves of the opportunity to do so by filing a petition for rehearing.

Finally, we get to the question of whether the agreements to arbitrate are enforceable under the National Arbitration Act. In holding the contracts to be enforceable the trial court relied on **Southland v. Keating**, 465 U.S. 1 (1984) (See Appendix B to Petitioners' Petition, pp14-15), and the Montana Supreme Court also relied on the **Southland** decision (see Appendix A to Petitioners' Petition, pp 4-7.) In holding that the defendants were entitled to arbitration by invoking the National Arbitration Act, both the trial court and the Montana Supreme Court rejected any argument that the arbitration agreements were not enforceable because they were contracts of adhesion.

Though they do not say so in so many words, the Petitioners are apparently asking this Court to hold as a matter of law that an arbitration cannot be enforced under the National Arbitration Act unless the agreement expressly sets out the rights that are given up by submission of a dispute to arbitration. This position is untenable.

Petitioners argue that the National Arbitration Act is

unconstitutional as applied to them, but they are asking for a much broader ruling than this. In fact, it seems they would have to ask for a broader ruling if they were to obtain the benefit of any ruling at all. Neither in trial court nor before the Montana Supreme Court did the petitioners allege they did not read or understand the contracts they signed agreeing to arbitration. We must therefore assume they understood the effect of the arbitration clause unless the burden of proving the enforceability of an arbitration clause is placed on the party asking for the arbitration. Such a holding, however, would turn contract law on its ear. The burden under arbitration agreements should be the same as it is in other contract situations. If a party seeks to avoid a written contract term the burden should be on that party to prove its unenforceability.

The situation before this Court is that of parties who signed an arbitration agreement and they are sorry they did so. Their only argument now is that the agreements did not expressly tell them what rights they were giving up and therefore that the arbitration clauses are unenforceable. This position is untenable.

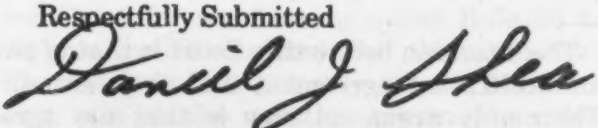
Based on these arguments we ask this Court to deny the Petition for Certiorari.

CONCLUSION

This Court should deny the petition for a writ of certiorari. The question raised here fails to comply with the Requirements of Rule 21 of this Court because the issue, if raised at all, was not properly raised in either the Montana trial court or before the Montana Supreme Court. Neither of these courts decided the question that is presented to this Court.

This Court should also deny the petition for a writ of certiorari because it fails to raise a substantial federal question.

Respectfully Submitted



DANIEL J. SHEA
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CERTIFICATE OF SERVICE

I, Daniel J. Shea, certify that on this 17 day of January, 1987, I personally served three copies of the Brief of Respondent Prudential-Bache Inc., in Opposition to Petition for Writ of Certiorari, on the following:

Mr. William Leaphart, Leaphart Law Firm, 1 North Last Chance Gulch, Helena, Montana 59601, Counsel for Petitioners;

Mr. Michael J. Mulroney, Luxan & Murfitt, Fourth Floor, Montana Club Building, P.O. Box 1144, Helena, Montana 59604, Counsel for Respondents G.T. Murray & Co., et al.

I further certify that all parties requred to be served have been served.

Daniel J. Shea

DANIEL J. SHEA

Supreme Court, U.S.
FILED
JAN 27 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-887

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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1986

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LARRY W. PASSAGE, et al.,

Petitioners,

vs.

PRUDENTIAL-BACHE SECURITIES, INC., et al.,

Respondents.

o

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

o

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No. 86-887

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In The

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LARRY W. PASSAGE, et al.,

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PRUDENTIAL-BACHE SECURITIES, INC., et al.,

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o

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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This Reply Brief is submitted to the Court pursuant to Supreme Court Rule 22.5, in answer to Respondents' Briefs in Opposition to the Petition for a Writ of Certiorari to the Supreme Court of the State of Montana.

The Petition for Certiorari raises the question as to the constitutionality of applying the Federal Arbitration Act to an adhesive arbitration clause which does not notify the adhering party that, in agreeing to arbitrate, he is waiving his right to trial by jury and judicial resolution of disputes.

THE QUESTION PRESENTED WAS PROPERLY RAISED IN THE LOWER COURTS

Although the Murray Respondents agree that both the State District Court and the Montana Supreme Court "fully considered" and decided the issues presented, (Murray, Brief in Opposition, page 4), Prudential contends that the issue presented has been "fashioned out of thin air", that it was neither raised nor ruled upon by the lower courts. The record, however, is clear that Passages have consistently contended that the arbitration clauses are revocable upon grounds that exist in equity or at law. (9 U.S.C. Sec. 2) In particular, that the clauses are unenforceable because they fail to advise adherents that, in agreeing to arbitrate, they are waiving their right to a jury trial.

The state district Court specifically acknowledged Passages' contention that the arbitration clauses were "contracts of adhesion" and therefore should be closely scrutinized and revoked upon grounds as exist in law or equity. (App. pp. 14-15). Although the District Court recognized the constitutional implications of an arbitration agreement (". . . an arbitration agreement is a waiver of the right to bring an action in court . . . " App. 16) it found that there were no grounds in law or equity for revocation of the clause in question.

In the Montana Supreme Court the Passages contended that the Federal Arbitration Act was unconstitutional as applied to the clauses in question since the Passages were not put on notice that they were waiving their right to a judicial forum.* (Passages' Appeal brief, pp. 7-12 and Reply Brief, pp. 4-5, filed with the Montana Supreme Court.) Both Prudential and Passages addressed this issue extensively during oral argument.

The Supreme Court passed on the issue by holding that even if the agreement were "adhesive", there was nothing in the record indicating that the parties' reasonable expectations had been exceeded or that the clause was unconscionable. (App. 7). In the view of the Montana Court, such provisions are "common" and "universal" in brokerage contracts and therefore the client is presumed to know and appreciate the consequences. Although this was less than an analytical approach, the issue was, nonetheless, passed upon.

The Court's cursory treatment of the issue is due, in large part, to the Court's having tacitly agreed with Prudential's argument that the Passages failed to refute the existence of any waiver of rights. Or stated another way, that the Passages failed to prove that the clauses exceeded their "reasonable expectations." As discussed below, however, the Court imposed the burden on the wrong party. It was *Prudential* that had the burden of establishing a valid waiver of a constitutional right.

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*In their brief before the Montana Supreme Court, pages 11-12, the Passages clearly argued as follows:

"The Nevada Court found the Pepper contract [693 P.2d 1259] to be a contract of adhesion even though the clause in question expressly waived the right to trial. It is significant that the arbitration clauses which were signed by the Passages do not even go that far. The Passages were not put on notice that they were waiving their rights to claim punitive damages and to receive a jury trial.

The Bache arbitration contract is a contract of adhesion which must be subject to close judicial scrutiny and should not be routinely enforced. Since it was Prudential-Bache that was the moving party (to compel arbitration), Prudential must establish the validity of the arbitration clause, i.e., plain and clear notification of its terms and an understanding consent. Prudential-Bache has not carried this burden and the contract must be declared unenforceable. As applied to the contracts in question, the National Arbitration Act is unconstitutional."

In their Reply Brief, pages 4-5, Passages argued:

"In the context of a contract of adhesion, the drafting party must show that the adhering party was notified of the terms and understood that he was waiving his constitutional right to a trial by jury; waiving his right to punitive damages, and waiving his right to appeal and seek judicial review. The arbitration clauses in question certainly do not contain any such explicit notice, and Prudential has made no attempt to prove that the Passages understood the effect of the arbitration clause."

Prudential Contends that Passages Failed to Prove that the Arbitration Clause Exceeded Their "Reasonable Expectations"

Prudential and Murray oppose the Petition on the basis that there is no evidence that Passages failed to read the clause; that they did not understand the clause or that they did not understand that they were waiving rights. Accordingly, Prudential concludes, ". . . we must assume they knew what they were doing." (Prudential's brief, p. 6). This position, which was adopted by the Montana Supreme Court, mistakenly assumes that Passages had the burden of producing evidence to refute a waiver of their right to a jury trial.

The arbitration clauses in question are boilerplate contracts which require the securities client to arbitrate all disputes. The form contracts contain no explanation of what arbitration means and no disclosure that, in signing the agreement, the client necessarily waives his right to trial by jury and full appellate review.

Prudential's position ignores the fact that an adhesive arbitration clause constitutes a waiver of the constitutional right to trial by jury. It is, therefore, the parties asserting the waiver (Prudential/Murray) who must prove a clear notification of the contract terms.

Montana's Constitutional Guarantee of Right to Trial by Jury is Protected by the Due Process Clauses.

In Montana, the right to trial by jury is guaranteed by Article II Section 26 of the 1972 Montana Constitution, which provides, in pertinent part, that, "The right of trial by jury is secured to all and shall remain inviolate." The State of Montana having granted litigants a constitutional right to trial by jury, such right is protected by the Due Process clauses of the Fifth and Fourteenth Amendments to the United States Constitution. *Lecates v. Justice of Peace Court No. 4 of State of Delaware,* 637 F.2d 898, 909 (3rd Cir. 1980). (surety bond requirement for state jury trial held violative of due process).

Since execution of an arbitration agreement constitutes waiver of a right protected by the Montana Constitution, it is the parties asserting waiver of that right (Prudential/Murray) who must make a showing that their clients are made aware of the arbitration clause and its significance.

A Waiver of Constitutional Rights Must, on its Face, be Clear

In *Fuentes v. Shevin,* 407 U.S. 67, 94-96 (1972), this Court held that state replevin statutes which did not provide for pre-seizure notice and hearing were unconstitutional under the Due Process Clause of the Fourteenth Amendment. The states of Florida and Pennsylvania had argued that the appellants, who signed conditional sales contracts, thereby waived their Due Process rights. The Court cited *D. H. Overmyer Co. v. Frick Co.,* 405 U.S. 174, 187 (1971), for the proposition that contractual waiver of Due Process rights must be "voluntarily, intelligently, and knowingly made." The Court noted that the Overmyer contract was a negotiated contract where the parties were "aware of the significance" of the waiver provision.

Contrary to *Overmyer,* the *Fuentes* contract provisions, like those sub judice, were in a printed form contract "unaccompanied by any explanations clarifying their meaning." 407 U.S. at 94. In short, the Fuentes conditional sales contract was a contract of adhesion.

In *Overmyer,* the Court observed that "where the contract is one of adhesion, where there is disparity in bargaining power, and where the debtor receives nothing for the [waiver] provision, other legal consequences may ensue." 405 U.S. at 188. In reviewing the conditional sales contract in *Fuentes,* the Court found that there was no need to concern itself with what those "other legal consequences" might be.

> "For a waiver of contitutional rights in any context must, at the very least, be clear. We need not concern ourselves with the involuntariness or

> unintelligence of a waiver when the contractual language relied upon does not, *on its face,* even amount to a waiver." (emphasis added) 407 U.S. at 95

It is further significant that the Court not only found the document deficient on its face, but also found that the parties asserting waiver had made no showing of actual waiver.

> "The appellees made no showing whatever that the appellants were actually aware or made aware of the significance of the fine print now relied upon as a waiver of constitutional rights." 407 U.S. at 95.

The principles established in *Fuentes* for interpretation of contracts of adhesion are equally applicable to the Prudential-Bache client agreement. An agreement which is nothing more than a bald requirement to arbitrate all disputes with no explanation of what "arbitration" means or the waivers inherent in such an agreement.

The Montana Supreme Court has held that courts indulge in every reasonable presumption against waiver of fundamental constitutional rights and "will not indulge in any presumption of waiver." *State v. Lucero,* 445 P.2d 731, 735, 151 Montana. 531, 538 (1968) (right to appointment of counsel) (citing *Johnson v. Zerbst,* 304 U.S. 458 (1937)). The United States Supreme Court has stated: "Indeed, in the civil no less than the criminal area, 'courts indulge every reasonable presumption against waiver.'" *Fuentes v. Shevin,* 407 U.S. at 94, footnote #31, citing *Aetna Ins. Company, v. Kennedy,* 301 U.S. 389, 393 (1936)

The Requirement of Clear Notification of Waiver does not Conflict with the Policy Favoring Arbitration.

Prudential and Murray contend that there is nothing in the record demonstrating that the clauses in question exceeded the reasonable expectations of the parties. Therefore, Prudential argues, the exception language in 9 U.S.C. Sec. 2 does not come into play and the Petition for Certiorari should be denied. This position, however,

assumes that there is a presumption of validity to the bald agreement to arbitrate and that the Passages failed to rebut that presumption. In fact, there is a presumption *against* the waiver of constitutional rights and *Prudential* must overcome that presumption in order to establish waiver.

The presumption against waiver of constitutional rights is not a presumption against arbitration. However, since an arbitration agreement necessarily implies a waiver of judicial resolution, (a fact recognized by the District Court, App. 16), a party relying on an adhesive arbitration clause must employ language which demonstrates, at the very least, a "clear" waiver of trial by jury and full appellate review. See *Fuentes v. Shevin,* 407 U.S. at 95.

CONCLUSION

The arbitration clause is in the record. (See attachment to Appendices to Petition) Like the *Fuentes* contract, Prudential's arbitration clause does not clearly demonstrate a waiver of a constitutional right. It is deficient on its face.

If, in fact, the record is lacking as to the parties' knowledge or expectations, that deficiency is the result of *Prudential's* failure to make a showing of actual waiver of the right to trial by jury.

For the above stated reasons, a writ of certiorari should issue to review the opinion of the Supreme Court of the State of Montana.

Respectfully submitted,

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